



MALTA RESOURCES AUTHORITY

Decision Notice 03/2012/ED

Decision of the 24th December 2012 issued in virtue of the Malta Resources Authority Act (Cap.423 of the Laws of Malta) to Liquigas Malta Ltd (C 44954) and Gasco Energy Ltd (C 44953) with regard to the proposals for amendments in the methodology and cost factors included in the LPG Price Mechanism applicable from 1st January 2013.

Whereas the Authority has established an LPG Price Mechanism in June 2010.

Whereas the Authority has received a proposal by Liquigas Malta Ltd (C 44954) and Gasco Energy Ltd (C 44953), (hereinafter 'Gasco-Liquigas'), for amendments to be made in the methodology and cost factors included in the LPG Price Mechanism as per correspondence dated 29th August 2012, 20th September 2012 and 06th November 2012 (attached doc GL1, GL2 and GL3 respectively) and the meetings held on the 31st July 2012, 28th August 2012, 27th September 2012, 3rd October 2012, 14th November 2012 and 27th November 2012 and with effect from 1st January 2013.

Whereas the Malta Resources Authority has taken note of the request and has made its review and considerations on the matter.

In view of the Authority's function to:

- regulate, monitor and keep under review all practices, operations and activities relating to energy;
- to regulate the price structure for any activity regulated by the Malta Resources Authority Act and where appropriate to establish the mechanisms whereby the price to be charged for the acquisition, production, manufacture, sale, storage and distribution thereof is determined;

the Authority is hereby issuing this decision.

(1) Projected Operating Costs

Gasco-Liquigas have requested the inclusion of the projected operating costs as detailed in the aforementioned proposal in the LPG Price Mechanism to be applicable as from 1st January 2013.

After due analysis, the Authority has approved the inclusion of these costs, subject to the conditions outlined below, and in view of the reason that they are not dissimilar to the most recent audited accounts (September 2012) and hence are considered to be real costs incurred by Gasco-Liquigas to carry out the operations of importation, storage and filling of LPG. This inclusion is subject to the following conditions being also adhered to by Gasco-Liquigas:

- (1) To cap the cost base for 3 years starting on the 1st of January 2013 until the year ending 31st December 2015 and adjusting only for annual inflation and subject to the exceptions in Condition (2); and
- (2) To exclude the raw material expense (product cost), depreciation expense and interest charges from the cost base detailed above; and

- (3) Notwithstanding Condition (1) above, extraordinary costs that may be incurred, such as the dismantling costs of the Qajzenza Plant, shall be included provided that reasonable justification and costings are provided beforehand; and
- (4) Notwithstanding Condition (1) above, to exclude the bank interest on long term loans which are in excess of 50% of the shareholders funds as at end of the prior financial year from the cost base detailed above; and
- (5) For the purpose of cost apportionment in the LPG Price Mechanism, the sales volumes of LPG sold is being capped as per Gasco-Liquigas proposal for the 3 years period starting on the 1st of January 2013 until the year ending 31st December 2015 unless there is an increase in the aforementioned sales volumes.

The reason for the above conditions is to ensure that Gasco-Liquigas maintain a realistic and efficient operational cost base for the 3 year period starting 2013 to 2016 to safeguard consumers from paying, via the LPG retail price, for unduly high operational costs arising from the underutilisation of the plant or from inefficient practices.

(2) Use of Platts Monthly Average Price instead of the consignment Invoice

Gasco-Liquigas have requested that the raw material expense (product cost) included in the LPG Price Mechanism is to be based on the average international market price, as published in the Platts Marketscan, of the last week of each month plus an additional \$70/ton premium reflecting primary transport and supplier's fee instead of using the actual consignment cost. The reason put forward is to incentivise efficiency in the purchase of LPG consignments.

After due consideration, the Authority notes that this request, if implemented, could have the following consequences:

- (1) it could result in a monthly change in the LPG retail price in-line with the monthly average Platts price movements irrespective of the actual consignment cost and stock purchase timing;
- (2) it could result in the Authority directly influencing the final consumer price rather than approving a maximum allowable profit margin to the wholesaler;
- (3) it could reduce price transparency in the LPG price mechanism since the selling price calculated therefrom will not be reflective of the actual consignment cost incurred by Liquigas.

In view of Section 1 and because of the above reasons, the Authority is therefore deciding that the actual consignment invoice should be continued to be used in the LPG Price Mechanism. Furthermore, the Authority has decided that in those instances where the actual consignment cost is 5% more expensive than the average international market price (Coasters FOB Med) for that particular month, the lower price will be included in the LPG Price Mechanism.

(3) The 5% annual cost reduction target requirement

Gasco-Liquigas is requesting that the 5% annual cost reduction target requirement on their operating costs is removed from the LPG Price Mechanism.

The Authority has duly noted that the operations of the Benghajsa Plant are already highly efficient and that furthermore proper safeguards have been put in place as detailed in the

Conditions set in Section 1 above, and hence it was decided that a continuation of an annual cost reduction target would be counter to the principle of fair pricing as specified in the 'LPG Price Review' of June 2010.

(4) Expense Apportionment

Gasco-Liquigas have requested that the non-specific expenses included in the LPG Price Mechanism are to be apportioned as 95% on cylinders and 5% on bulk.

The Authority has decided that, since Gasco-Liquigas did not present a reasoned basis for this ratio of apportionment, the apportionment of non-specific costs will be based on the percentage of the projected annual sales between LPG sold in cylinders and LPG sold in bulk, this being the most transparent and fair methodology for apportioning such costs across the product range.

Furthermore, the Authority has examined the accounts pertaining to the operations of the Bengahsa Plant and noted that the costs of storage and filling of LPG in cylinders are not unbundled between these two services and hence, the Authority is henceforth obliging Gasco-Liquigas to carry out an exercise that identifies a transparent and fair methodology on how to unbundle the aforementioned services. Such exercise is to be concluded by the first quarter of 2013.

(5) Increase in the Maximum Allowable Mark up

Gasco-Liquigas have requested an increase in the maximum allowable mark-up from the current €41/ton to €140/ton.

The Authority has undertaken a detailed study to determine a fair rate of return for Gasco-Liquigas and after due consideration was given to its present cost setup, particularly the financing arrangements of the business, and after comparing the said cost setup with those of similar companies operating in a similar markets abroad, it is decided that the current maximum allowable profit mark-up of €41/ton is to be retained in the LPG Price Mechanism.

Furthermore it is decided to include this maximum allowable mark-up as its equivalent in 'earnings before interest and tax' in the LPG Price Mechanism. The reason for this part of this decision is to safeguard consumers from paying for exceedingly and unduly high bank interest expenses that Liquigas-Gasco might incur on its capital outlay and to incentivise a shift towards increasing the working capital of the business and to therefore be able to avail from economies of scale in the purchase of LPG and to promote price stability by Gasco-Liquigas availing from the full storage capacity of the Benghajsa Plant.

Mario P. Galea

Chairman

Malta Resources Authority